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SUBJECT: SHAHRISTANI UNLIKELY TO ADHERE TO SCHEDULE OF IMF
FUEL PRICE INCREASES

Classified By: Acting Economic Minister Counselor Edward Kloth for Reas
ons 1.4 (b) and (d).

¶1. (C REL GBR) Summary: At the November 2-5 Government of Iraq (GOI) - International Monetary Fund (IMF) meeting in Amman, Jordan, Minister of Oil Husayn al-Shahristani agreed to very ambitious targets for fuel price increases before the end of 2006. The price increases discussed in Amman are actually higher than the targets established in the original IMF Stand-by Arrangement (SBA). For certain products, such as premium gasoline and diesel, these prices are higher than the average prices in the Gulf region that were quoted in the SBA as benchmarks. Despite an increase in the price of regular gasoline, information from senior Ministry of Oil (MinOil) officials (protect) suggests that most targets established in Amman will not be met. Most original SBA requirements will not be met by the end of the year either. Further, MinOil has requested an \$800 million budget supplemental for additional fuel imports, a violation of SBA terms prohibiting supplemental requests. The IMF has told emboffs that if the GOI demonstrates that it, "has permanently fixed the problem," by raising fuel prices to market levels, then the supplemental--which has been approved by the Iraqi Council of Representatives (CoR)--would be considered an acceptable "temporary deviation."

Current Fuel Prices and Increases Planned through January 2007

¶2. (C REL GBR) In late November, MinOil officials provided emboffs with a schedule of fuel prices that included increases planned for implementation as of January 1, 2007. The current "official" prices according to this document are as follows:

Premium gasoline:	350 dinars/liter (\$0.25/liter)
Blended gasoline:	250 dinars/liter (\$0.17/liter)
Regular gasoline:	250 dinars/liter (\$0.17/liter)
Kerosene:	75 dinars/liter (\$0.05/liter)
Diesel:	150 dinars/liter (\$0.10/liter)
Liquefied petroleum gas (LPG):	2000 dinars/12 kg cylinder (\$1.40/12 kg) without ration card
	1000 dinars/12 kg cylinder (\$0.70/12 kg) with ration card

The document also indicates that there is a planned increase in the price of LPG effective January 1, 2007, raising the price to 1500 dinars/12 kg cylinder even with a ration card. The price will stay at 2000 dinars/12 kg cylinder without the ration card. There are no near-term plans to raise the price of kerosene due to recent shortages and increased demand during winter months.

Shahristani's Plan for Targeted Price Increases and Regional

Implementation

¶3. (C REL GBR) Emboffs received reports from MinOil that Shahrستاني is approaching increases from the point of view that proceeds from the sale of imported products should cover GOI expenditure on imports. Shahrستاني appears to be focusing on ways to achieve this financial result by charging different rates for industrial/government users and other rates for consumers. This approach not only circumvents the objective of eliminating subsidies and undermining fuel smuggling and the black market, but the financial results are likely to balance on paper only. MinOil has had great difficulties collecting payment from GOI Ministries and State-Owned Enterprises (SOEs), and improving collection rates while raising prices is unrealistic.

¶4. (C REL GBR) It is reported that MinOil plans to charge the same price for regular and blended gasoline, and to raise the price to 350 dinars/liter (\$0.25/liter) sometime in 2007. Senior MinOil officials told emboffs that since it is hard to control quality during blending, eliminating the price difference makes sense. (Comment: The SBA schedule does not address blended gasoline. End comment.) When emboffs asked if premium gasoline prices would be raised accordingly, the official said that they should be, but no specific increase was projected at this time. According to MinOil sources, Shahrستاني also intends to implement the regular/blended gasoline price increases first in Baghdad, then in central Iraq, and then in the South. When asked about implementation of price increases for the North, sources said that Shahrستاني did not include the North in this implementation plan. (Comment: Due to a more liberalized market for fuel products, it is likely that official MinOil prices have less relevance in the Kurdistan Region. End comment.)

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Deviation from IMF SBA Schedule of Increases and Amman Agreement

¶5. (C REL GBR) Anticipated official prices by the end of 2006 will not comprehensively meet IMF SBA targets, deviating as follows:

targets	Deviation	Official prices	SBA
Premium gasoline (dinars/liter):		350	450
(\$0.32)	-100		
Regular/blended gasoline (dinars/liter):		250	200 (\$0.14)
50			
Kerosene (dinars/liter):		75	115
(\$0.08)	- 40		
Diesel (dinars/liter):		150	175 (\$0.12)
- 25			
LPG (dinars/12 kg):		2000/1000	1000
(\$0.70)	1000/0		

¶6. (C REL GBR) Post information concerning the November 2-5 IMF meetings in Amman between the IMF and GOI indicates that Minister Shahrستاني agreed to raise prices to the following levels by the end of 2006:

	Amman mtg prices	Gulf averages
Premium gasoline (dinars/liter):	750 (\$0.53)	\$0.27
Regular gasoline (dinars/liter):	250 (\$0.17)	\$0.24
Blended gasoline (dinars/liter):	500 (\$0.35)	N/A
Kerosene (dinars/liter):	150 (\$0.10)	\$0.17
Diesel (dinars/liter):	300 (\$0.21)	\$0.18
LPG (dinars/12 kg):	3000 (\$2.11)	N/A

MinOil sources have made it clear that Shahrستاني does not intend to implement such increases.

Fuel Import Supplemental and 2007 Budget Allocation

17. (C REL GBR) The CoR has approved the \$800 million supplemental request for fuel purchases, and it appears that the State Oil Marketing Organization might use it for additional kerosene and LPG shipments coming through Basrah. MinOil reports that plans to eliminate the import budget for 2007 were based on the assumption that refinery improvements and the recently passed Fuel Import Liberalization Law (FILL) that allows private companies to import fuel products would cover demand. Refinery improvements, however, have not been proceeding according to plan and continued problems at the Bayji Refinery are further limited domestic fuel production, so another option was tabled to reduce the import budget by half from \$2.4 billion in 2006. MinOil instead pushed to allocate \$3 billion for imports to be sold at market prices so that the funds could be paid back to the Ministry of Finance. There has, thus far, been little interest expressed by the private sector in importing fuel, and inadequate fuel import regulations published by MinOil suggest that the FILL will not have its intended effect anytime soon. The current draft of the 2007 budget shows no allocation for fuel imports, and emboffs are following up to determine if this section will be amended before the draft goes to the CoR. (Comment: Even if MinOil plans to sell imports at market prices, it will need funds to cover initial expenditures. End comment.)
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